

[4830-01-u]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG-121268-97]

RIN 1545-AW10

Travel and Tour Activities of Tax Exempt Organizations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations clarifying when the travel and tour activities of tax exempt organizations are substantially related to the purposes for which exemption was granted. These proposed regulations are intended to augment the guidance that currently exists with respect to travel tours and the unrelated business income tax.

DATES: Written comments and requests for a public hearing must be received by July 22, 1998.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG-121268-97), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG-121268-97), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC. Alternatively, taxpayers may submit comments electronically via the internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS internet site at

http://www.irs.ustreas.gov/prod/tax_regs/comments.html.

FOR FURTHER INFORMATION CONTACT: Robin Ehrenberg, (202) 622-6080
(not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

An organization generally exempt from tax under section 501(a) of the Internal Revenue Code ("Code") must pay tax on its unrelated business taxable income, as defined in section 512. Section 512(a)(1) defines unrelated business taxable income ("UBTI") as the gross income derived by any organization from any unrelated trade or business (as defined in section 513) regularly carried on by the organization, less the deductions which are directly connected with the conduct of the trade or business. Gross income from an unrelated trade or business and any deductions directly connected to that trade or business are both computed in accordance with the general income tax rules of chapter 1 of the Internal Revenue Code, subject to the modifications provided in section 512(b).

Section 513(a) generally defines an unrelated trade or business as any trade or business the conduct of which is not substantially related (aside from the need of an organization for income or funds or the use it makes of the profits derived) to the exercise or performance by the organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501.

A "trade or business" is defined in Section 1.513-1(b) of the Income Tax Regulations as having the same meaning it has for purposes of section 162, and "generally includes any activity carried on for the production of income from the sale of goods or performance of services." The key test of whether an activity constitutes a trade or business is whether the activity was conducted with a profit motive. See U.S. v. American Bar Endowment, 477 U.S. 105 (1986); Professional Insurance Agents of Michigan v. Commissioner 726 F.2d 1097 (6th Cir. 1983); National Water Well Association v. Commissioner, 92 T.C. 75 (1989). The regulations further provide that an activity conducted for the production of income does not lose its character as a business "merely because [it is] carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of the organization." This "fragmentation rule," as it is commonly known, may result in different treatment of related activities under the unrelated business income tax.

Section 1.513-1(d)(2) of the Income Tax Regulations provides that a trade or business is "substantially related" to exempt purposes only where the conduct of the business activities has a substantial causal relationship to the achievement of the exempt purposes (other than through the production of income) of the organization conducting the trade or business. Thus, a trade or business is substantially related for purposes of section 513 only if the conduct of the trade or business contributes

importantly to the accomplishment of the organization's exempt purposes.

In recent years, taxpayers and Congress have asked the IRS to publish guidance addressing questions relating to the unrelated business income tax treatment of income generated from travel tours conducted by tax exempt organizations. Although the IRS has issued a number of revenue rulings addressing situations in which tax exempt organizations sponsor travel tours, most of these rulings have analyzed whether an organization that offers travel tours as its primary activity can qualify as a charitable or educational organization described in section 501(c)(3) of the Code.

Rev. Rul. 67-327, 1967-2 C.B. 187, holds that an organization whose purpose is to arrange group tours for students and faculty of a university in order to allow them to travel abroad does not qualify for exemption because the organization operates essentially as a commercial travel agency. The ruling concludes that the organization's activities are not "educational" as that term is defined in Treas. Reg. § 1.501(c)(3)-1(d)(3)(i)(a), because they do not provide instruction or training of individuals for the purpose of improving or developing their capabilities.

In contrast, in Rev. Rul. 69-400, 1969-2 C.B. 114, an organization that selects students and faculty members interested in a certain foreign history and culture and enrolls them at foreign universities and arranges for on-site tours conducted by

local scholars that complement classroom studies, is held to be exempt. Rev. Rul. 69-400 distinguishes Rev. Rul. 67-327 on the basis that the organization in the later ruling is arranging for instruction not just travel.

Rev. Rul. 70-534, 1970-2 C.B. 113, describes an organization that conducts travel study tours as its primary activity. Tours are geared toward students, but others can take the tours as long as they participate in the mandatory study programs. Organized study, taught by certified teachers, is conducted five to six hours a day, and a library of materials related to the courses being taught is available. Exams are given, each student is graded and a state board of education allows credit for a student's participation in the study tour program. The revenue ruling concludes that the organization furthers educational purposes because it performs training and instruction for the purpose of allowing individuals to improve and develop their capabilities, and is, therefore, described in section 501(c)(3).

Rev. Rul. 77-366, 1977-2 C.B. 192, concerns an organization that arranges and conducts ocean cruises for ministers, church members and their families for the purpose of providing continuing education in an atmosphere supporting spiritual renewal. The organization's activities include lectures, discussions, workshops and some shore activities that further charitable purposes. However, because of the extensive resources the organization devotes to social and recreational programs, the scheduling of those programs relative to the schedule for the

exempt purpose programs, and other facts and circumstances, the organization was held to be also serving a substantial nonexempt purpose and, therefore, not to qualify for exemption as an organization described in section 501(c)(3).

The Tax Court applied a similar analysis to an organization operating a mountain lodge when it held that the organization failed to qualify as a religious organization described in section 501(c)(3). Although religious activities were offered to guests in addition to a wide range of recreational activities, guests were not required to participate in the religious activities, and the record failed to show that the recreational activities were insubstantial. See The Schoger Foundation v. Commissioner, 76 T.C. 380 (1981).

In contrast, Rev. Rul. 77-430, 1977-2 C.B. 194, holds that an organization conducting weekend retreats is furthering its stated purpose of advancing religion. Individuals come to participate in a program of seminars, lectures, prayer sessions and meditation led by ministers and priests that are scheduled on an hourly basis throughout the day. Recreational activities are not scheduled, but are available to participants during their limited free time. Under these facts and circumstances, the ruling holds that the facilities are being used to advance religion and that recreational activities are incidental to the accomplishment of this purpose.

The revenue rulings all focus on the degree of educational or religious content participants are expected to receive in each

travel program in determining whether the activity serves an exempt purpose. The same approach was taken in the one ruling that has specifically addressed the application of the unrelated business income tax to income generated by travel tours. Rev. Rul. 78-43, 1978-1 C.B. 164, describes the travel tour activity of a university alumni association. The association's program of approximately ten tours per year is open to all current members and their immediate families and is planned with various travel agencies. Each travel agency pays a per person fee to the association. The tours do not include any formal educational program and do not differ substantially from commercially operated tours. Rev. Rul. 78-43 concludes that there is no causal relationship between arranging the travel tours described in the ruling and the achievement of an exempt purpose. Accordingly, the ruling holds that the sale of tours to members is an unrelated trade or business within the meaning of section 513.

These proposed regulations are intended to augment the guidance that currently exists with respect to travel tours and the unrelated business income tax. The proposed regulations also provide additional guidance regarding the fragmentation rule and the distinctions that may be necessary among different tours or activities that are part of a single organization's travel program.

The IRS and Treasury are soliciting comments on these proposed regulations. In particular, because the IRS relies

heavily on review of records to determine whether an organization's trade or business activities further an exempt purpose, comments are requested on whether the IRS should specify the types of records organizations should keep to establish the activity's purpose.

Explanation of Provisions

The proposed regulations add a new §1.513-7 providing that the determination of whether travel tour activities of tax exempt organizations are substantially related to an organization's exempt purposes is a question of facts and circumstances. The proposed regulations set forth a series of examples to illustrate how various facts and circumstances would be analyzed.

Proposed Effective Date

These regulations are proposed to be effective for taxable years beginning after the date final regulations are published in the **Federal Register**. For prior taxable years, the IRS will continue to apply principles of existing law.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to

section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. All comments will be available for public inspection and copying. A public hearing may be scheduled if requested in writing by a person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these regulations is Robin Ehrenberg, Office of Associate Chief Counsel (Employee Benefits and Exempt Organizations). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.513-7 is added to read as follows:

§ 1.513-7 Travel and tour activities of tax exempt organizations.

(a) Travel tour activities that constitute a trade or business, as defined in § 1.513-1(b), and that are not substantially related to the purposes for which exemption has been granted to the organization constitute an unrelated trade or business with respect to that organization. Whether travel tour activities conducted by an organization are substantially related to the organization's exempt purpose is determined by looking at all relevant facts and circumstances. Section 513(c) and § 1.513-1(b) also apply to travel tour activity. Application of the rules of section 513(c) and § 1.513-1(b) may result in different treatment for individual tours within an organization's travel tour program.

(b) Examples. The provisions of this section are illustrated by the following examples:

Example 1. O, a university alumni association, is exempt from federal income tax under section 501(a) as an educational organization described in section 501(c)(3). As part of its activities, O operates a travel tour program. The program is open to all current members of O and their guests. O works with travel agencies to schedule approximately 10 tours annually to various destinations around the world. Members of O pay \$X to the organizing travel agency to participate in a tour. The travel agency pays O a per person fee for each participant. Although the literature advertising the tours encourages O's members to continue their lifelong learning by joining the tours, and a faculty member of O's related university is invited to join the tour as a guest of the alumni association, none of the tours includes any scheduled instruction or curriculum related to the destinations being visited. By arranging to make travel tours available to its members, O is not contributing importantly to the accomplishment of its educational purpose. Rather, O's program is designed to generate revenues for O by regularly offering its members travel services. Accordingly, O's tour program is an unrelated trade or business within the meaning of section 513(a) of the Code.

Example 2. N is an organization formed for the purpose of educating individuals about the geography and culture of the United States. It is exempt from federal income tax under section 501(a) as an educational and cultural organization described in section 501(c)(3). N engages in a number of activities to accomplish its purposes, including offering courses and publishing periodicals and books. As one of its activities, N conducts study tours to national parks and other locations within the United States. The study tours are conducted by teachers and other education professionals. The tours are open to all who agree to participate in the required study program. The study program consists of community college level courses related to the location being visited by the tour. While the students are on the tour, five or six hours per day are devoted to organized study, preparation of reports, lectures, instruction and recitation by the students. Each tour group brings along a library of material related to the subject being studied on the tour. Examinations are given at the end of each tour and N's state board of education awards academic credit for tour participation. Because the tours offered by N include a substantial amount of required study, lectures, report preparation, examinations and qualify for academic credit, the tours clearly further N's educational purpose. Accordingly, N's tour program is not an unrelated trade or business within the meaning of section 513(a) of the Code.

Example 3. R is a section 501(c)(4) social welfare organization devoted to advocacy on a particular issue. On a regular basis throughout the year, R organizes a travel tour for its members to Washington, D.C.. The tours are priced to produce a profit for R. While in Washington, the members follow a schedule according to which they spend substantially all of their time over several days attending meetings with legislators and government officials and receiving briefings on policy developments related to the issue that is R's focus. Bringing members to Washington to participate in advocacy on behalf of the organization and learn about developments relating to the organization's principal focus is substantially related to R's social welfare purpose. Therefore, R's operation of the travel tours does not constitute an unrelated trade or business.

Example 4. S is a membership organization formed to foster cultural unity and to educate X Americans about X, their country of origin. It is exempt from federal income tax under section 501(a) and is described in section 501(c)(3) as an educational and cultural organization. Membership in S is open to all Americans interested in the X heritage. As part of its activities, S sponsors a program of travel tours to X. All of S's tours are priced to produce a profit for S. The tours are divided into two categories. Category A tours are trips to X that are designed to immerse participants in the X history, culture and language. The itinerary is designed to have participants spend substantially all of their time while in X receiving instruction on the X language, history and cultural heritage. Destinations are selected because of their historical or cultural significance or because of instructional resources they offer. Category B tours are also trips to X, but rather than offering scheduled instruction, participants are given the option of taking guided tours of various X locations included in their itinerary. Other than the optional guided tours, Category B tours offer no instruction or curriculum. Even if participants take all of the tours offered, they have a substantial amount of time free to pursue their own interests once in X. Destinations of principally recreational interest, rather than historical or cultural interest, are regularly included on Category B tour itineraries. Based on the facts and circumstances, sponsoring Category A tours is an activity substantially related to S's exempt purposes, and does not constitute an unrelated trade or business with respect to S. However, sponsoring Category B tours does not contribute importantly to S's accomplishment of its exempt purposes and is designed to generate a profit for S.

Therefore, sponsoring the Category B tours constitutes an unrelated trade or business with respect to S.

Deputy Commissioner of Internal Revenue